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REPORT

Three Lessons from Past Financial Crises at Yale

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There are at least three lessons we might learn from previous financial crises that can help us think about our current COVID 19 financial crisis.

First, there have been many crises, and after all of them Yale eventually emerged richer than before. With the 1970s oil embargo and stagflation, the endowment shrunk by 40% in real terms. In 1990, Yale President Benno Schmidt declared that he had just learned the shocking news that the buildings required $1 billion of deferred maintenance when the endowment was $3 Billion. In the 2008 Great Recession, the value of Yale's endowment fell by 20%.

Yet after all these financial calamities, here we are at Yale in 2020 with an endowment that is now 7 times higher than the annual budget, whereas 30 years ago it was 3 times higher. Not only is the endowment greater than ever, but the Colleges and buildings are more beautiful than ever. So the first lesson is not to panic about potential lost wealth.

The second lesson is not to try to save money during and after a crisis by cutting things that are crucial to the research and teaching mission of Yale and that will be hard to restore once Yale recovers. Though the endowment and buildings have greatly improved since our three crises, the faculty has not, relative to our competition. The main reason, I believe, is that in every crisis we froze hiring and sometimes salaries too, and kept their growth slow for too long. See the accompanying charts on faculty size and faculty salaries taken from the Senate Faculty Excellence Report from 2018-19. The decline in Yale's relative position after each crisis is apparent.

Freezing faculty hiring is tempting in a pinch. Nobody here is affected. And money is saved. But it is an illusion that you can make up for the lost hiring later when things return to normal. Faculty will retire. Some others will go somewhere else. Those who remain will all get older. The missing new faculty would have been on average younger, more energetic, more in tune with recent scholarship, more diverse, and more productive than the older faculty. And that itself makes it harder to recruit. To "pause" hiring is to take a step backward.

We are sometimes told that others are freezing, so we won't lose ground. To the extent that others are freezing, we have an extraordinary opportunity to hire distinguished young faculty. Imagine if Yale had the only departments hiring on the junior market. Recognizing this, our well-endowed competitors always seem to pause less than we do. In the 2008 crisis, every university endowment plummeted, most to about the same extent as Yale's. They faced the same financial pressures we did to cut back hiring. Yet we lost ground to almost all our competitors, which, as after previous crises, we have not regained. Making up for lost ground is extraordinarily difficult.

An alternate narrative that some in the administration have given is that the lesson of the 2008 crisis is that Yale should have reacted by making bigger cuts in hiring just after the markets began to fall. That way, it is alleged, Yale could have reached equilibrium sooner and then resumed hiring. It is baffling how it could be argued that the best strategy for climbing higher is to start lower.

The impulse to cut sooner also runs directly counter to our endowment spending rule. The Yale endowment spending rule, described in a companion piece, prescribes that after an actual loss of wealth, Yale should spread the necessary reductions in spending from the endowment over many years. It formally recognizes the principle that abrupt cuts cause unnecessary damage.[1]

The third lesson is that in crises, faculty governance is more important than ever. I began my term as Senate Chair by writing you about the glorious tradition of Yale faculty governance. Nearly every momentous decision, from tenure standards, to freedom of expression, to co-education, to diversity, was initiated by a faculty committee with a faculty chair. Those committees spoke widely about their ideas with other faculty, and their recommendations were further vetted by the board of permanent officers.

Yale has also made momentous decisions without faculty governance. Many of those decisions turned out badly. For example, some years after the Doob committee recommendation to admit women, President Kingman Brewster arranged a deal to go co-ed by merging with Vassar, without consulting broadly with faculty. Only after the plan was announced did it become apparent that how to combine the faculties had not been thought through, and the merger was called off.

To take another example, in response to what he had called the deferred maintenance crisis, Benno Schmidt announced his plan to shrink the faculty by 15%, without consulting faculty experts. He appointed a committee of chairs of the biggest departments and a few others that met to decide how to make the cuts, agreeing in the end to eliminate five smaller departments. The general faculty was enraged when they found out. A committee was appointed to examine the President's economic assumptions and evaluate the process by which the cuts had been decided. The President was forced to submit a document spelling out exactly the nature of the budget problem and the ten-year plan for coping with it. The committee found that the economics in the President's white paper was badly flawed, and that the budget problem was far smaller than the President had imagined. The committee also found that the process for deciding what to cut was flawed. Soon thereafter the Provost, Dean, and President resigned.

I tell this story not to condemn the people who made the decisions. They were the leading figures of Yale. They were all wise, and all dedicated to Yale. But they did not have the full picture. They were caught up in implementing a plan to shrink the faculty, without the time needed to examine the grand strategy, including whether such cuts were really necessary.

Appointing Coronavirus committees is an excellent step. The committees contain many excellent people, and they are doing vital work. I applaud the President and Provost for establishing these committees. But they are all implementation committees, chaired at the very top of the structure by deans. We have time still to include the faculty in making important strategic decisions. The University will make better decisions if the faculty are better informed and able to participate in formulating the grand strategy.

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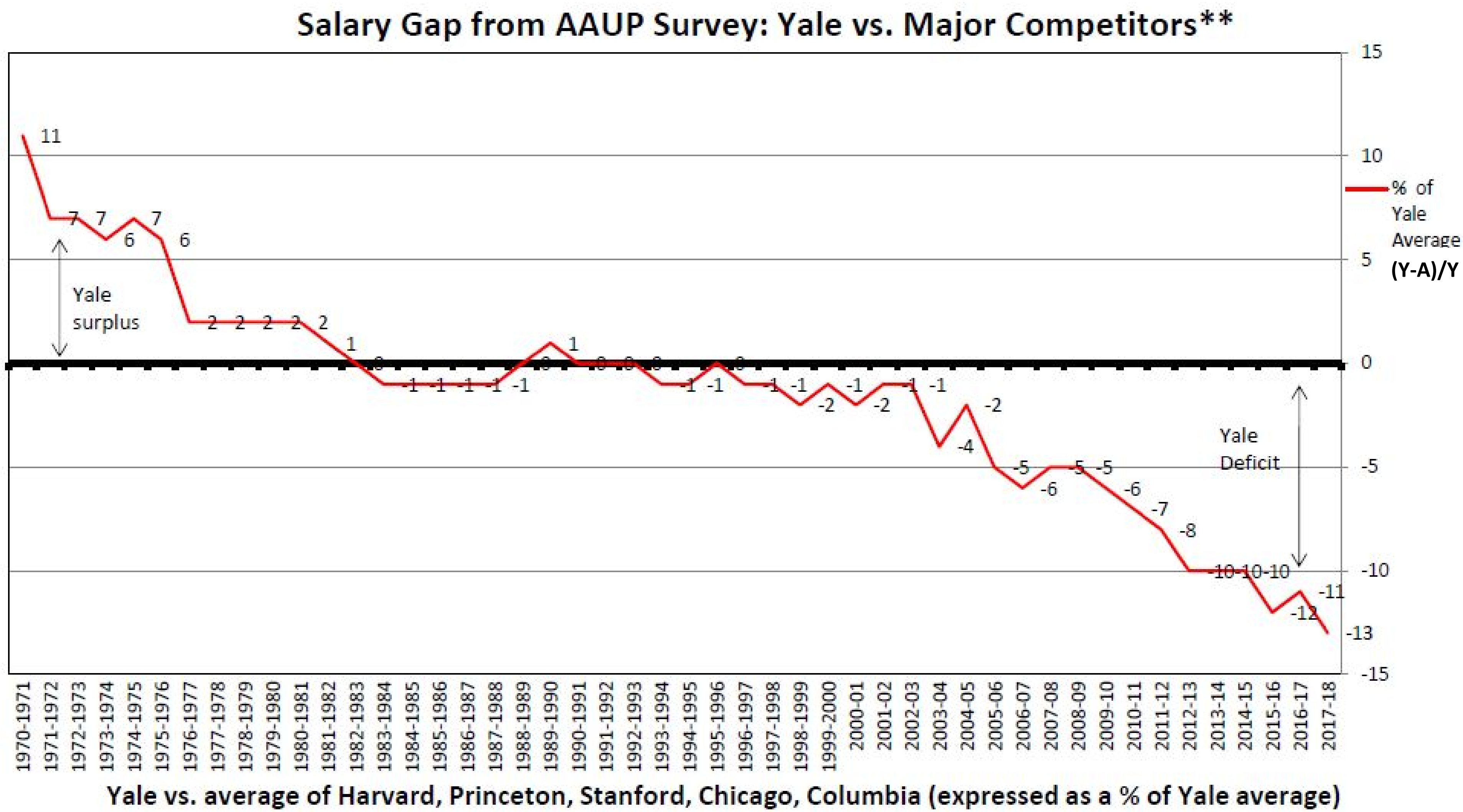
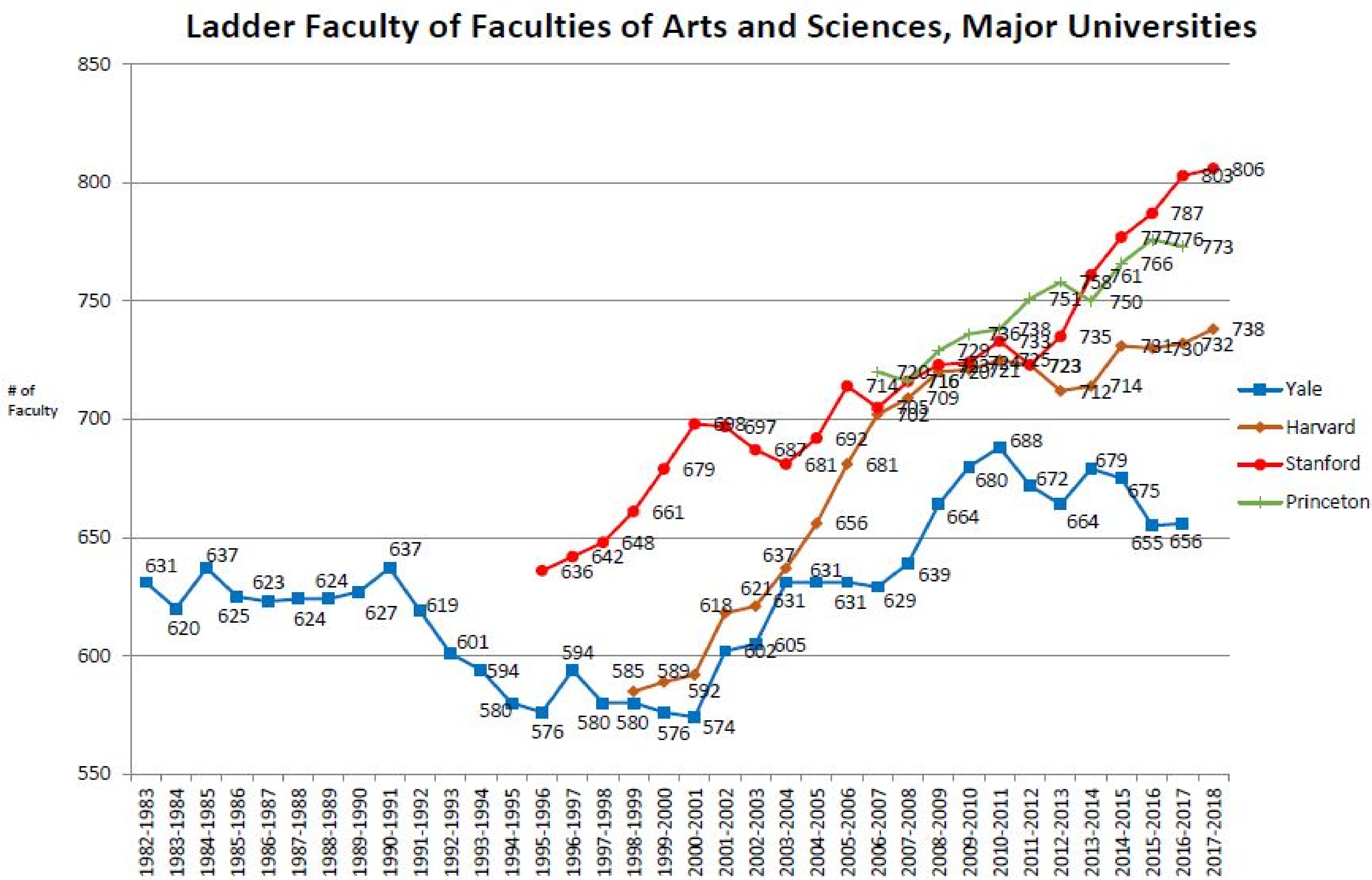
[1] A different mistake Yale might have made before the 2008 crisis, and continued after the crisis, was to lavish spending on projects that were not central to the core research and teaching mission of the university.

In the period from 1970-1980, Yale faculty salaries were significantly above those in other major private research universities.* From 1980-2005 Yale is about even. Since 2005 a large salary gap has opened. The gap shown here measures the difference between Yale average faculty salaries and average faculty salaries at five competitors, measured as a percentage of Yale salaries. ** The data looks only at full professors, for which there is the best comparability across schools.



*There is no comparable data before 1970.

**The five competitive private universities are Harvard, Princeton, Stanford, Chicago, and Columbia.



*These data were taken from the websites of the four universities. No data was available from Columbia.